

Legislation includes tax breaks for small businesses that Congressman Sestak has called for since 2008

June 17, 2010

WASHINGTON, DC— Today, Congressman Joe Sestak voted for and the U.S. House of Representatives passed the Small Business Lending Fund Act of 2010 (H.R. 5297), by a vote of 241 to 182, which will spur small business growth by freeing up credit for small businesses and the smaller banks which lend to them. Congressman Sestak has been championing key provisions of this bill since 2008 to support small businesses and promote economic growth in Pennsylvania and across the country. The Small Business Lending Fund Act will be combined with H.R. 5846, the Small Business Jobs Tax Relief Act, passed Tuesday, June 15, as a single, deficit-neutral bill for Senate consideration. The overall legislation builds from Congressman Sestak's efforts to support working families, recognizing from the early stages of the economic crisis that small business growth and job creation are the key to the overall recovery of our economy.

“As Vice Chairman of the House Small Business Committee, I know that over the past decade, small businesses created as many as 80 percent of new jobs; and after the most recent economic recession in 2001-- firms with fewer than 20 employees created 40 percent of new jobs,” Congressman Sestak said. “That is why I have called for these tax breaks for small businesses and for action to free up credit from small banks to small businesses. This legislation accomplishes both of these needs – without adding to the debt-- and will stimulate our economic growth in the months ahead.”

Congressman Sestak has touted these provisions as a key pillar of his working families platform. Pennsylvania needs small business job creation to regain its competitiveness both in the United States and globally. Over the past three decades, the growth of small businesses in Pennsylvania has been less than half that in the rest of the country. The Commonwealth is now the second oldest state in the country as employment opportunities have moved to other states and countries. Incentivizing entrepreneurship and economic growth through small business will restore Pennsylvania’s economic strength.

“I have called for comprehensive legislation to strengthen small businesses, because it is the most effective approach to economic growth and securing the long-term economic security of Pennsylvania and the nation,” Congressman Sestak said. “Small businesses will be the engine of our economic recovery, so long as we provide the proper incentives to growth through tax credits and responsible access to credit.”

Since the economic crisis began small businesses have had an exceptionally difficult time obtaining credit, and this has resulted in lower than normal job creation and decreased entrepreneurship. The SBA backed 30 percent fewer bank loans to small businesses last quarter than it did a year earlier. In addition, small businesses are finding it difficult to access *affordable* credit. More than 40% of small businesses have had credit limits put or reduced on their

company credit cards, and 63% have experienced an interest rate increase on their card.

Small businesses will create jobs across all sectors of the economy as a result of this legislation. Over 80 percent of the country's nearly 290,000 manufacturing firms have fewer than 20 employees, and over 98 percent have fewer than 500 employees. Over 80 percent of all home builders are small businesses, and small businesses make up approximately 90% of the retail sector.

See below for full details on the legislation the House passed today:

H.R. 5297

I. Small Business Lending Fund

The bill establishes a small business lending fund intended to expand the availability of credit to small businesses. It authorizes \$30 billion to the Treasury Department for creation of such a

fund, which the department would invest in preferred stock or other financial instruments from eligible institutions. Any proceeds would be used to pay down the public debt.

The measure creates incentives for participants to increase small business lending within the first two years of the program by reducing the dividend or interest rate on the investment — to as low as 1% — the more the institution increases its small business lending compared to the baseline year-end 2009 level. In general, for the first two years the rate would be 5%, and a participant's small business lending increases by less than 2.5%, the dividend or interest rate would remain 5%.

For lending that increases by more than 2.5%, the measure creates the following incentives — a dividend or interest rate of 4% for lending that has increased by more than 2.5%, but less than 5%; a dividend or interest rate of 3% for lending that has increased by more than 5%, but less than 7.5%; a dividend or interest rate of 2% for lending that has increased by more than 7.5%, but less than 10%; and a dividend or interest rate of 1% for lending that has increased by 10% or more.

The bill establishes a penalty rate of 7% for institutions that do not increase their small business lending after two years.

It creates a 9% rate for participating institutions on interest and dividend payments, which would apply to participants who have not paid back their loans within four and a half years.

The bill sets a repayment deadline of 10 years from the beginning of the date of capital investment under the program.

II. State Small Business Credit Initiative

The bill establishes a state small business credit initiative to assist states with efforts to increase the amount of capital made available by private lenders to small businesses. It authorizes \$2 billion for the creation of the program.

III. Small Business Early-Stage Investment Program

The measure authorizes \$1 billion for the SBA for a small business early-stage investment program to provide equity investment financing to support early-stage small businesses. Early stage small businesses would be defined as those that have not generated gross annual sales revenues exceeding \$15 million in any of the previous three years. (The provisions are similar to those in a larger small business financing bill, H.R. 3854, passed by the House of Representatives last fall).

H.R. 5486

IV. SMALL BUSINESS TAX INCENTIVES

General Provisions

100% Exclusion of small business capital gains. Under current law, Section 1202 provides a fifty-percent (50%) exclusion for gain from the sale of certain small business stock that is held for more than five years. The amount of gain eligible for the Section 1202 exclusion is limited to the greater of 10 times the taxpayer's basis in the stock, or \$10 million gain from stock in that small business corporation. This provision is limited to individual investments and not the investments of a corporation. The non-excluded portion of section 1202 gain is taxed at the lesser of ordinary income rates or 28 percent, instead of the lower capital gains rates for

individuals. The
and Recovery Act

American Reinvestment
(the

“Recovery Act”) temporarily increased the Section 1202 exclusion to seventy-five percent (75%) for qualifying stock acquired in 2009 and 2010. The bill would temporarily increase the amount of the exclusion to one hundred percent (100%) for qualifying stock acquired after March 15, 2010 and before January 1, 2012.

This provision is estimated to cost \$1.962 billion over 10 years.

Limitations and Reporting on Certain Penalties

Small business penalty relief. Under current law, Section 6707A of the Internal Revenue Code imposes a penalty on the failure to disclose a “reportable transaction” on any tax return or information statement. There are six categories of reportable transactions, one of which is a “listed transaction.” A “listed transaction” is a type of transaction identified by the IRS through guidance as a tax avoidance transaction. The penalty for failure to disclose a reportable transaction (other than a listed transaction) on a return is \$10,000 in the case of individuals and \$50,000 in any other case. For listed transactions, the penalty is \$100,000 in the case of individuals and \$200,000 in any other case. The bill generally would make the penalty for failing to disclose reportable transactions (including listed transactions) proportionate to the underlying tax savings.

This provision is estimated to cost \$176 million over 10 years.

Annual reports on penalties and certain other enforcement actions. Under current law, the Internal Revenue Service is not required to report annually to the Congress on penalties assessed during the year. The bill would require the IRS Commissioner to report annually to the Ways and Means Committee and the Senate Finance Committee on penalties assessed, and enforcement actions taken, with respect to tax shelters.

This provision is estimated to have no revenue effect.

Other Provisions

SBA non-recourse loans treated as at-risk. Under current law, business expenditures are deductible against related business income even if they are financed with non-recourse debt. However, in order to prevent taxpayers from engaging in certain types of tax shelters, Congress enacted the “at-risk” rules to prevent taxpayers from using expenses financed with non-recourse debt to shelter unrelated income. There are exceptions to the at-risk rules in situations where Congress believed that, even though a project was financed with non-recourse debt, that it is likely that the financing will be repaid and that the purchaser will have real equity in property financed with the non-recourse debt (e.g., real estate). The bill would provide an exception to the “at-risk” rules for non-recourse loans that are guaranteed by the Small Business Administration (SBA). The passive activity loss rules would still apply to these expenses to prevent taxpayers from engaging in tax shelter transactions.

This provision is estimated to cost \$942 million over 10 years.

Increase deduction for start-up expenditures. Under current law, taxpayers may deduct up to \$5,000 in trade or business start-up expenditures. The amount that a business may deduct is reduced by the amount by which start-up expenditures exceed \$50,000. Start-up expenditures are defined as expenses paid or incurred in connection with investigating the creation of a business, and do not include expenses that would otherwise be allowed to be expensed (i.e., capital or equipment investments). For taxable years beginning in 2010 or 2011, the bill would increase the limit on the tax deduction for trade or business start-up expenditures from \$5,000 to \$20,000, and increase threshold amount for reducing such limit to \$75,000.

This provision is estimated to cost \$508 million over 10 years.

Benefits under the Small Business Borrower Assistance Program are excluded from gross income. The bill would create a Small Business Borrower Assistance Program that would provide assistance to small businesses that are struggling to meet their obligations to creditors. The bill would exclude from gross income any amounts that are received under this program and, correspondingly, would also deny tax benefits associated with payments on loans that are attributable to amounts received under this program. *This provision is estimated to have no revenue effect.*

V. OFFSET PROVISIONS

Require a minimum 10-year term for grantor retained annuity trusts (“GRATs”). Grantor retained annuity trusts (“GRATs”) allow taxpayers to structure a transfer of assets to another individual in such a way that substantial gift taxes may be avoided. A GRAT is generally an irrevocable trust in which the grantor retains an annuity interest and transfers a remainder interest to another individual. For gift tax purposes, in valuing the gift of the remainder interest to the

beneficiaries of such a trust, current law allows taxpayers to deduct the value of the retained annuity interest from the value of the transferred assets. The value of the retained annuity interest is determined by computing the present value of the annuity at a statutory growth rate. If the property transferred to the trust appreciates in value at a rate that is greater than the statutory growth rate, the excess appreciation will be transferred tax free to the trust beneficiaries. One significant risk to this type of tax planning is that, if the grantor dies during the trust term, the portion of the trust necessary to satisfy the annuity amount is included in the grantor’s gross estate for estate tax purposes. This generally eliminates the benefit of using a GRAT. As a result, taxpayers have created short-term GRATs to maximize their gift tax planning while minimizing the chances that they might die during the trust term. The bill would include the President’s 2011 Budget proposal to require a minimum 10-year term for GRATs to significantly limit this type of planning. In connection with requiring a minimum 10-year term, the bill would also require that the value of the remainder interest must be greater than zero and that the annuity must not decrease during the first 10 years of the GRAT term. As a result, the

bill would require taxpayers to take on a greater risk that they might die during the GRAT term in order to take advantage of the gift tax benefits of using a GRAT. *This provision is estimated to raise \$5.297 billion over 10 years.*

Crude tall oil ineligible for cellulosic biofuel producer credit. In 2008, Congress enacted a \$1.01 per gallon tax credit for the production of biofuel from cellulosic feedstocks in order to encourage the development of new production capacity for biofuels that are not derived from food source materials. The House of Representatives has voted on numerous occasions to prevent unprocessed fuels (e.g., black liquor) from claiming this tax credit. Congress is aware that some taxpayers are seeking to claim the cellulosic biofuel tax credit for processed fuels that are highly corrosive, such as crude tall oil (another waste by-product of the paper manufacturing process). The bill would limit eligibility for the tax credit to fuels that are not highly corrosive (i.e., fuels that could be used in a car engine or in a home heating application). *This proposal is estimated to raise \$1.849 billion over 10 years.*

Born and raised in Delaware County, former 3-star Admiral Joe Sestak served in the Navy for 31 years and now serves as the Representative from the 7th District of Pennsylvania. He led a series of operational commands at sea, including Commander of an aircraft carrier battle group of 30 U.S. and allied ships with over 15,000 sailors and 100 aircraft that conducted operations in Afghanistan and Iraq. After 9/11, Joe was the first Director of "Deep Blue," the Navy's anti-terrorism unit that established strategic and operations policies for the "Global War on Terrorism." He served as President Clinton's Director for Defense Policy at the National Security Council in the White House, and holds a Ph.D. in Political Economy and Government from Harvard University. According to the office of the House Historian, Joe is the highest-ranking former military officer ever elected to the U.S. Congress.

###